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Real estate industry developments - 2002/03; Audit risk alerts

American Institute of Certified Public Accountants

AUDIT RISK ALERTS

Real Estate Industry Developments—2002/03

American Institute of Certified Public Accountants

AICPA

Notice to Readers

This Audit Risk Alert is intended to provide auditors with an overview of recent economic, technical, and professional developments that may affect the audits they perform. The AICPA staff has prepared this document. This publication is an *Other Auditing Publication* as defined in Statement on Auditing Standards (SAS) No. 95, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 150). Other Auditing Publications have no authoritative status; however, they may help the auditor understand and apply SASs.

If an auditor applies the auditing guidance included in an Other Auditing Publication, he or she should be satisfied that, in his or her judgment, it is both appropriate and relevant to the circumstances of his or her audit. The auditing guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted upon by a senior technical committee of the AICPA.

The AICPA staff is grateful to Colleen K. Conrad for her assistance and contributions to this Audit Risk Alert.

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How This Alert Can Help You

This Audit Risk Alert can help you plan and perform your real estate industry audits. The knowledge delivered by this Alert can provide assistance in achieving a more robust understanding of the business and economic environment in which your clients operate. This Alert is an important tool in helping you identify the significant risks that may result in the material misstatement of the financial statements. Also, this Alert delivers information about emerging practice issues and information about current accounting, auditing, and regulatory developments.

If you understand what is happening in the real estate industry, and if you can interpret and add value to that information, you will be able to offer valuable service and advice to your clients. This Alert can assist you in making considerable strides in gaining that industry knowledge and understanding it.

This Alert is intended to be used in conjunction with the AICPA general *Audit Risk Alert — 2002/03* (product no. 022333kk).

Industry and Economic Developments

The U.S. Economy

As of the third quarter of 2002, anxious economists are downgrading their forecasts, and some crucial sectors of the economy are pushing the likelihood of a rebound into next year because of the abrupt slowdown in the economic recovery.

For now, the overall economy is expanding, but sluggishly. Jobs are growing, but barely. And with a depressed stock market, concerns over a possible military action in Iraq, fears of terrorist strikes, and corporate scandals weighing on the national psyche, there is none of the exuberance that marked the recovery in the late 1990s.

Analysts argue over whether the summer slump was just a pause in the rebound—perhaps as companies obsess about making sure their financial reports are accurate—or something more ominous. Even optimists say the chances of a double-dip recession—when a recession is followed by a short period of growth, only to be followed by another recession—once slim, are now up to 20 percent or more.

The economy appears to be in a struggle between declining business confidence and strong consumer spending. Eventually, consumer demand should overcome business wariness, unless cautious businesses cut so many jobs that consumers finally give up. The same dynamic was at work during the fall of 2001. After September 11, the business sector froze, the consumer sector did not, and eventually consumer demand jump-started the economy.

The underlying economic fundamentals remain relatively sound and point toward a moderate economic growth scenario. However, stock market weakness, coupled with recent data releases, has prompted downward forecast revisions.

Stock Market Woes

Accounting scandals and corporate bankruptcies have generated tremendous investor uncertainty resulting in a dramatic decline in stock prices. While this is disconcerting, Wall Street scandals are not expected to play a *significant* adverse role on consumer spending or overall economic growth. Furthermore, any negative economic impacts generated by stock price declines are expected by economists to be constrained to third-quarter activity.

Potentially, the decline in stock market prices can affect real economic activity by reducing consumer wealth and by adversely affecting consumer buying attitudes. Both conditions could reduce consumer spending activity.

Stock prices have declined throughout 2002, resulting in a multi-trillion dollar decline in wealth holdings. Most economists believe the decline in wealth will have a relatively small adverse impact on consumer spending. The wealth decline is primarily a temporary paper setback for investors. The underlying economic fundamentals are relatively sound and the profit picture facing corporate America is showing mixed signs of improvement. This suggests that once investors regain confidence in corporate financial reporting, the market will rebound strongly.

Furthermore, the current environment of low interest rates and stock uncertainty has prompted additional support to real estate activity—providing additional support for real estate appreciation.

Current Monetary Policy

In November 2002, for the first time in 11 months, the Federal Reserve Board lowered the federal funds rate to 1.25 percent, its lowest level in 41 years. At this point the Fed believes that the risks between inflation and very slow economic growth are balanced.

The Sarbanes-Oxley Act

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. The Act includes far-reaching changes in federal securities regulation that could represent the most significant overhaul since the enactment of the Securities Exchange Act of 1934. The Act prescribes a system of federal oversight of public auditors through a Public Company Accounting Oversight Board, a new set of auditor independence rules, new disclosure requirements applicable to public companies and insiders, and harsh civil and criminal penalties for persons who are responsible for accounting or reporting violations. The Act also imposes new restrictions on loans and stock transactions involving corporate insiders.

A more complete summary of the Act is available on the AICPA Web site at www.aicpa.org/info/sarbanes_oxley_summary.htm and in the AICPA general *Audit Risk Alert 2002/03*.

General Industry Trends and Conditions

Although the U.S. economy appears to point toward a moderate economic growth scenario, most sectors of real estate will continue to feel the pinch for the next 12 months, according to the Urban Land Institute's (ULI) mid-year Real Estate Forecast.

With the exception of housing, real estate performance will likely lag behind the economy, the outlook says, cautioning that rising vacancies coupled with declines in commercial rents and property values have reduced profitability for many owners. Several ULI members provided industry insights for the report, which included a member survey.

The forecast notes that recent encouraging economic news has led to predictions of a 4 percent growth rate in the U.S. gross domestic product by 2003. However, despite the likelihood of improvement for the economy, commercial real estate is still reeling from the sharp economic downturn of last year. In particular, the lack of job growth has been the single most damaging factor affecting the industry, the study says.

Only 49 percent of the respondents to ULI's forecast survey expect the profitability of real estate firms to be "good to excellent" through mid-2003, compared to 60 percent one year ago. In addition, 11 percent are expecting profitability to range between modestly poor and abysmal. The ULI forecast projects strongest profits among real estate services firms, followed by financial services/institutional investors, residential or resort developers, private real estate operating firms and developers, public real estate operating companies, and finally, real estate investment trusts.

According to the forecast, development prospects will be strongest for housing in general. It ranks master-planned communities, middle-income detached housing, and infill housing as having the most potential. Urban mixed-use properties, mixed-use town centers, and attached housing are also expected to offer modestly good prospects. Offering the least potential are upscale/luxury hotels, followed by (in order) downtown office space, high-rise suburban office space, resort hotels, midprice and economy hotels, regional malls, and low-rise suburban office space.

ULI survey participants voted Washington, D.C., as the "most favored" investment market, with New York, Los Angeles, Chicago, and San Diego rounding out the top five. The forecast comments that:

- Washington is "strong because of the tight market that predated the recession and the fact that demand remains strong in many sectors of the local economy, particularly government and defense contracting."
- New York suffered "the loss of the World Trade Center [which] has taken a lot of space out of the market and kept the market from deteriorating....Infusion of state and federal funds to revitalize lower Manhattan will also help."
- Los Angeles "will lead because of its diversified economy—not heavily dependent on technology sectors—and its strong population growth."
- Chicago "will benefit from its broadly diversified economy and from recovery in the manufacturing sector."
- San Diego "will get a boost from increased defense spending."

The retail sector appears the least affected by the weakened status for the commercial real estate industry, primarily because "the prospects for attractive rent increases were not particularly favorable last year and have not changed much since," the forecast says. The for-sale housing sector is expected to fare much better than the commercial side, with infill housing and middle-income detached homes experiencing fair to strong price increases. In general, consumer-driven real estate markets will fare better than business-driven markets over the coming year, the forecast concludes.

In addition to forces in the general economy, other forces will continue to reshape the real estate industry, including the following:

- *Globalization.* Through consolidation and expansion, real estate companies are becoming international enterprises. Numerous opportunities for global expansion exist outside the United States, particularly in Europe and Asia. However, U.S. companies that expand overseas must be savvy about local conditions and must carefully assess the risks of doing business in an unfamiliar environment.

- *Larger real estate companies.* Traditionally, real estate companies tended to be privately held, entrepreneurial enterprises. This continues to change. Today, there are more than 150 public real estate companies. Recently, Standard & Poor's changed its policy and added several real estate investment trusts (REITs) to its indexes. In addition, primarily through mergers and acquisitions, larger real estate companies are continuing to emerge.

  Larger public companies have different operating characteristics than smaller private companies. For example, larger public companies may have more comprehensive internal controls (including internal audit departments) and more sophisticated information technology (IT) to help them manage their real estate assets.

- *Technology.* Technology has played and will continue to play a significant role in reshaping the industry. The Internet has greatly enhanced the marketing of commercial property and facilitated the exchange of information about underlying industry conditions. The result has been a significant decrease in the time available to make real-estate-related decisions. In what had previously been a relatively slow-moving industry, the speed and availability of information made possible by new technology have increased the pace at which real estate business is conducted.

As a result of these recent trends, the real estate industry will endure significant and lasting change. The exact nature of these changes is still largely unknown; more time is needed to observe and analyze the interaction of these dynamics. This is still the embryonic stage of what is sometimes described as a revolution, but there is a consensus that the real estate industry is now more complex and sophisticated than ever before.

Industry Segment Conditions

Office Market Conditions

The office market has fallen farther and faster than anyone thought possible a year ago. The vacancy rate, which reached a cyclical low point of 8.5 percent in the third quarter of 2000, rose to over 15 percent in 2002, well above the 10 percent rule of thumb that constitutes a balanced market.

While tenants continued to vacate office space, the construction pipeline added 20.5 million square feet of competitive space (multitenant plus single tenant), a process that was initiated before the recession.

The economy shows signs of recovery, but job growth is anemic, corporate earnings have been disappointing so far this year, and the recovery remains fragile. A sustained increase in business capital spending is required to power the expansion. As long as corporate earnings are poor, there isn't much to encourage capital spending, corporate hiring, or office leasing activity. Analysts are predicting the nation's vacancy rate to peak above 16 percent by the end of 2002 and then begin a moderate decline in 2003.

Industrial Market Conditions

The industrial market is bottoming out, thanks to a decline in construction coupled with a slight pickup in demand. The vacancy rate is expected to peak at around 9 percent, far below the 13.7 percent peak that defined the bottom of the last recession 10 years ago. Small tenants and owner-users are leading the charge, while large companies remain paralyzed by earnings fears and the roller coaster stock market. The stabilizing industrial market disguises dramatic variations among different regions, some of which clearly remain in decline, while others are seeing a healthy pick up in demand.

Nationally, the vacancy rate increased by less than one-tenth of 1 percent during the second quarter of 2002. By comparison, it had been rising by an average of 59 basis points per quarter over the prior five quarters. The five markets posting the sharpest vacancy declines were San Antonio, Orlando, Pittsburgh, Los Angeles, and

Chicago. The five markets posting the sharpest increases were Des Moines, Phoenix, Boston, Sacramento, and Oakland.

The improvement from recent quarters is due both to supply and demand factors. On the supply side, the amount of space under construction continues to fall. New space completions totaled 15 million square feet in the second quarter, half the quarterly average of 31 million square feet completed from 1999 through 2001. The amount of space still under construction totals 53 million square feet, well below half the 122 million square feet underway less than two years ago. On the demand side, the manufacturing sector of the economy continues to expand slowly even as the economy has lost momentum in recent weeks.

The outlook for the industrial market depends entirely on the economy. Developers and lenders have cut back on construction. The economy is expanding, but not quickly enough to encourage hiring activity. Despite the moribund economy, the industrial market is moving into the recovery phase of the real estate cycle, but it is unlikely to bounce back quickly. Analysts expect the vacancy rate to begin a slow decline late this year, continuing into next year.

Retail Market Conditions

Of all property types, retail probably has been the least affected by the recession. Retail sales are down and shopping center vacancy rates are up, but not to the extent of prior recessions. In fact, consumers have carried the economy through the recession. With the economy teetering on the brink of a deep recession after September 11, shoppers rushed to the malls and auto showrooms like it was their patriotic duty to spend the country out of recession. This was coupled with the fact that consumers had more money in their pockets due to low gas prices, tax rebate checks, low interest rates, and a rush of mortgage refinancing activity.

The downside is that the rebound in retail sales and the retail property market is likely to be less robust than in prior recoveries. Several factors point to this soft rebound:

- Gas prices have risen steadily during the year.

- Home sales remain high, but may be poised for a fall. A decline in home sales would dampen sales at home furnishings and improvement stores.
- Mortgage refinancing may decline if interest rates begin to rise again.
- Joblessness continues to rise.

All of this means that retail sales will be weaker than usual following a recession, but most analysts expect moderate year-over-year gains, nevertheless.

Market conditions vary widely by region. Several markets are seeing tight conditions, including Dallas, Los Angeles, and Silicon Valley, whereas other markets, such as Atlanta, Columbus, and Kansas City, are saturated. Most markets remain in balance, with new and expanding retailers replacing those who have closed or downsized.

Residential Market Conditions

Unlike the broader economy, the single-family market showed no signs of recession in 2001 or 2002. Sales of new and existing homes reached record levels in 2002. With the Federal Reserve Board setting its benchmark for interest rates at its lowest level in 41 years, and with strong demographics, homebuilding has shrugged off stock market woes and growing unemployment to keep growing. Earlier forecast numbers for residential construction have now been revised upward. Housing starts were predicted to drop below 1.5 million for the year from 1.6 million in 2001, but they are now expected to finalize at 1.55 million starts for 2002.

However, there are signs that the housing boom may be coming to an end. For the past several years, a rare confluence of factors—including low interest rates, low unemployment, easy credit standards, and tight housing supply—have combined to stimulate an unprecedented surge in home sales, sending prices rocketing up. The result: housing has been one of the most important bulwarks of the U.S. economy, even as it gets buffeted by plunging stocks, business scandals, and the war on terror. Now, however, some of the factors behind the housing boom show signs of fading, and indicators that traditionally foretell weakness in the market are emerging.

In more than one hundred U.S. cities, home prices have climbed at least twice as fast as household incomes since 1998, according to data analyzed for the *Wall Street Journal* by the economic consulting firm Economy.com. Nationally, prices have risen at more than triple the rate of incomes in the last two years, a surge that is steadily putting home ownership out of the reach of more people. The nationwide price and income figures had tracked together closely through the 1990s boom.

Though the problem is most common in the Northeast and on the West Coast, the list of localities with out-of-proportion prices includes large cities around the country such as Atlanta, Las Vegas, Denver, Houston, Tucson and Charleston, S.C. In Miami, home prices have shot up 58 percent since the beginning of 1998, while incomes have risen only 16 percent. In New York's Long Island suburbs, an 81 percent increase in home prices compares with a 14 percent rise in incomes. In Boston, home prices have jumped 89 percent, compared with income gains of only 22 percent.

In some cities, including San Diego, Miami, and Washington, the run-ups have accelerated in the past year, confounding expectations that the market would cool off before it got too far out of line. In the late 1980s and early 1990s, the presence of such "bubblettes" in such places as Boston, Houston, and Los Angeles signaled the end of a boom cycle.

On the multifamily side, building permits declined significantly during August, dropping 19 percent to 295,000 units permitted. On a year-over-year basis, multifamily permits fell more than 2 percent from 302,000 permits issued in August 2001.

The most active states remained the same during the month of July. Four of the top five states witnessed an increase in permit levels in comparison to July 2001. On the upside were Florida, Texas, California, and New York, while activity in Georgia declined. Overall, these five states account for nearly 46 percent of total multifamily permit activity in the nation.

The effect of the recent economic slowdown and low mortgage rates has been seen primarily within the nation's multifamily housing market. Starting midway through 2001, the apartment market saw steadily declining demand over a period of three quarters. As mounting job losses in some areas forced some households to relocate and falling mortgage rates spurred a new surge of first-time homebuyers, vacancies rose to a national average of 8.5 percent in the second quarter of 2002.

Hospitality Market Conditions

Occupancies in the hospitality sector will suffer from a continued slowdown in corporate travel in 2002. The demand for lodging is being rocked by a variety of economic and security concerns, including the failure of the economy to strengthen to the extent most economists had forecast, the negative wealth effect from the sharp decline in stock values in throughout this year, the erosion in consumer confidence, increasing frustration with the inconvenience of air travel, and heightened fears of U.S. action against Iraq.

The economy and the specific effects of the recent events will restrain lodging demand growth and encourage continued discounting through the end of 2002, according to PricewaterhouseCoopers. They are forecasting revenue per available room (RevPAR) to decline 2.3 percent this year. Without a catalyst for strong rebound in business travel in the short term, RevPAR will increase by only 3.5 percent in 2003. A more robust outlook is delayed to 2004, when RevPAR is expected to improve by 5.6 percent.

Real Estate Investment Trusts

The prices for REIT shares bottomed out in late 1999 and have seen a major rebound throughout 2000, 2001, and 2002. Equity REITs, which make money by buying and then renting out offices, apartments, shopping malls, and other buildings, have posted a 55 percent cumulative total return since year-end 1999, according to the National Association of Real Estate Investment Trusts. Over the same stretch, the Standard & Poor's 500-stock index has slumped 35 percent. However, after two years of increases, returns on REITs fell 9 percent in the third quarter of 2002, according to Morgan Stanley.

Green Street Advisors of Newport Beach, California, calculates the value of the real estate owned by REITs and then compares it with current REIT share prices. There has often been a yawning gap between these two numbers, with REIT shares selling at both steep discounts and steep premiums to this "net asset value." But over the past dozen years, REITs—on average—have traded at net asset value.

Environmental Factors Affecting Financial Reporting

Pressures to Perform

Businesses deal with pressures that arise from a variety of sources, both internal and external. External pressures come primarily from the capital markets, with many believing that Wall Street's expectations too often drive inappropriate management behavior. Management often is under pressure to meet short-term performance indicators, such as earnings or revenue growth, financial ratios tied to debt covenants, or other measures. Most often the intentions of management are to follow sound and ethical practices, but pressure may build when analysts and shareholders demand short-term performance and when competitors move closer to the edge of the range of acceptable behavior.

Members of top management also may be pressured to demonstrate that shareholder value has grown as a consequence of their leadership. Boards of directors often create pressure on management to meet financial and other goals. There also is a well-established practice of motivating management with stock options and other equity instruments that attempt to align management and shareholder interests. With their own performance and compensation tied to operating or financial targets, management can, in turn, push hard on personnel throughout the company, including those in operating business units, to meet what may be overly optimistic goals. This high-pressure environment can create an incentive to adopt practices that may be too aggressive or inconsistently applied in an effort to meet perceived expectations of the capital markets, creditors, or potential investors. At some point, the motivation behind earnings management can become strong enough for individuals with the right opportunity to move beyond acceptable practices, even though they are otherwise honest individuals. The greater the pressures, the more likely individuals will rationalize the acceptability of their actions.

Complexity and Sophistication of Business Structures and Transactions

The increasing sophistication of the capital markets and the creativity of investment bankers and other financial advisers have fostered a wide variety of complex financial instruments and structured financial transactions. Many companies now use complex transactions involving transactions with one another in the form of purchases/sales of assets, derivative transactions, and intricate operating agreements designed to meet a specific reporting objective as well as an economic objective. Some companies have transferred assets off-balance-sheet or arranged for units to be acquired by special purpose entities, joint ventures, limited liability corporations, or partnerships, retaining substantially all the risks and rewards of ownership but without "control." Recent business failures, including the boom-bust cycle of dot-com enterprises, have focused attention on the potential risks of these business structures and transactions and the challenge of reporting them in a way that is easily understood by financial statement users.

Many companies have adopted rapid and innovative forms of business expansion, either through acquisitions and mergers, or internal development. Such rapid expansion may have been necessary to support high price-to-earnings multiples. However, it also creates many challenges, including integrating disparate operations, melding internal control processes, and meeting expanded financing needs. Liquidity crises or financial reporting failures may result.

Current Audit and Accounting Issues

Assessing Audit Risks in the Current Environment

The proper planning and execution of an audit has always required you to have a thorough understanding of the real estate industry and the nature of your client's business. For most audit firms, this in-depth understanding means that the most experienced partners and managers must become involved early and often in the audit process. In today's real estate environment, your judgment, knowledge, and experience are even more important than they were in the past.

During the past year, the U.S. economy has suffered some significant declines: consumer confidence has dropped, plant closings and layoffs have increased dramatically, profit margins for many companies have slipped, and many companies have failed.

Periods of economic uncertainty lead to challenging conditions for companies attributable to potential deterioration of operating results, increased external scrutiny, and reduced access to capital. During such times, professional skepticism should be heightened and the status quo should be challenged.

More specifically, in today's economic environment, you should keep the following points in mind as you plan and perform audits of real estate clients.

- Understand how your client is affected by changes in the current business environment.
- Understand the stresses on your client's internal control over financial reporting, and how they may affect its effectiveness.
- Identify key risk areas, particularly those involving significant estimates and judgments.
- Approach the audit with objectivity and skepticism, notwithstanding prior experiences with or belief in management's integrity.

- Pay special attention to complex transactions, especially those presenting difficult issues of form versus substance.
- Consider whether additional specialized knowledge is needed on the audit team.
- Make management aware of identified audit differences on a timely basis.
- Question the unusual and challenge anything that doesn't make sense.
- Foster open, ongoing communications with management and the audit committee, including discussions about the quality of financial reporting and any pressure to accept less than high-quality financial reporting.
- When faced with a "gray" area, perform appropriate procedures to test and corroborate management's explanations and representations, and consult with others as needed.

Audit Planning

As you prepare to conduct quarterly reviews and annual audits of real estate companies, you need to realize that your clients may be working in a new business environment as a result of the stagnant economy. If this is the case, you must gain an understanding of this new environment to adequately plan and perform the audit. Although not all real estate companies are directly affected by the economic downturn, most in the industry could experience some possible indirect effects. Many clients will experience effects related to shifts in demand, collectibility of accounts receivable, or valuation of their investments.

Evaluating Audit Risks

We know that your evaluation of audit risk should start with a solid understanding of your client's business. To develop this understanding, you should be knowledgeable about the entity's strategies for dealing with business conditions—both current conditions and those most likely to exist in the near future. In the real estate industry, business conditions vary greatly across property types and from region to region. The risks associated with developing office buildings are different from those faced by a homebuilder; a warehouse facility in the Northeast may face different issues than a similar facility located on the Pacific Coast. For this reason, you must be knowledgeable about property types and the location in which the entity operates.

Audit risk can be altered when a real estate entity enters into new property types or new geographic markets. You should be aware that current economic conditions might force your real estate clients to expand beyond their traditional sphere of operations. During audit planning, you should identify new property types or geographic locations and carefully assess the risks associated with the client's change in operating strategy.

Professional Skepticism

The third general audit standard stipulates that due professional care be exercised in planning and conducting an audit engagement. Due professional care requires that you exercise professional skepticism in gathering and evaluating audit evidence. Although you neither assume that management is dishonest nor assume unquestioned honesty, you should consider the increased risk associated with the potential increases in external pressure faced by management during the current economic climate.

As a result of perceived external pressures, companies may be tempted to manage earnings by using nonrecurring transactions or by changing the method of calculating key estimates, such as reserves, fair values, or impairments. Companies may also adopt inappropriate accounting practices resulting in improper recognition or omission of financial transactions. Material nonrecurring transactions may require special disclosure to facilitate the readers' understanding of the reported financial results, and the guidance in Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes,* should be applied in reporting the effects of changes in estimates. Inappropriate transactions or accounting practices that may result in errors requiring adjustments of financial statements might include premature recognition of revenue, failure to appropriately accrue for contingent liabilities that are probable and estimable, and failure to record unpaid purchase invoices. Additionally, you should be particularly skeptical of fourth-quarter events that result in significant revenue recognition, loss accrual, or noncash earnings.

The appropriate level of professional skepticism is needed when corroborating management's representations. Management's explanations should make business sense. Additionally, you may need to consider corroborating management's explanations with members of the board of directors or audit committee.

Other indicators of potential increased accounting and reporting risk calling for increased professional skepticism include:

- Liquidity matters
  - —The company is undercapitalized, is relying heavily on bank loans and other credit, and is in danger of violating loan covenants.
  - —The company appears to be dependent on an initial public offering for future funding.
  - —The company is having difficulty obtaining or maintaining financing.
  - —The company is showing liquidity problems.
- Quality of earnings
  - —The company is changing significant accounting policies and assumptions to less conservative ones.
  - —The company is generating profits, but not cash flow.
- Management characteristics
  - —Management's compensation is largely tied to earnings or the appreciation of stock options.
  - —The company appears vulnerable to the weakening economic conditions, and management is not proactive in addressing changing conditions.
  - —The company's management is selling its investment in company securities more than in the past.

— There is a significant change in members of senior management or the board of directors.

Consideration of Fraud

Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), provides the primary guidance on your responsibilities for detecting fraud-related misstatements when performing a financial statement audit.[1]

Some examples of fraud risk factors that may exist in real estate entities include the following:

- An excessive interest by management in maintaining or increasing the reported amount of real estate assets through the use of aggressive appraisal assumptions
- The use by management of unusually aggressive accounting practices in recognizing revenue from real estate sales
- Complicated criteria for recognizing sales transactions, making it difficult to assess the completion of the earnings process
- Inadequate responses or an unwillingness to respond to inquiries about known regulatory or legal issues, for example, the presence of environmental contamination on an entity-owned site
- Significant related-party transactions
- Significant side-agreements or transaction terms not previously disclosed
- Key contracts awarded without a competitive bidding process

1 Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), supersedes SAS No. 82, of the same name; amends SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 230, "Due Professional Care in the Performance of Work"; and amends SAS No. 85, *Management Representations* (AICPA, *Professional Standards*, vol. 1, AU sec. 333). See the discussion of this new SAS in the "New Auditing and Attestation Pronouncements and Other Guidance" section later in this Alert.

The general state of the recent economy may raise several fraud risk factors. For example, management may be under significant pressure to obtain additional capital, or the entity may depend on debt with debt covenants that are difficult to maintain under the circumstances.

Auditing Estimates

The real estate industry uses estimates in a variety of ways. For example, supplemental current values of real estate assets and the recognition and measurement of impairment losses both require management to make estimates of future events or assumptions about current conditions.

When auditing estimates, you should be familiar with SAS No. 57, *Auditing Accounting Estimates* (AICPA, *Professional Standards*, vol. 1, AU sec. 342); the AICPA Practice Aid *Auditing Estimates and Other Soft Information*; and SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties.*

Currently, certain segments of the real estate industry are in decline. Certain estimates, for example, expected future cash flows used in the determination of possible asset impairment, require management to make assumptions about future events and conditions. Be skeptical of cash flow and other performance projections that assume overly optimistic upward trends will occur.

Pay close attention to the underlying assumptions used by management when auditing accounting estimates. Management is responsible for making the estimates included in the financial statements. Those estimates may be based in whole or in part on subjective factors, such as judgment based on experience with past as well as current events, and with conditions it expects to exist. You should be alert to the possibility of management's overreliance on economic information based on favorable conditions to predict future outcomes.

> **Help Desk**—Landauer Real Counselors publishes the annual *National Real Estate Market Forecast*, which can be downloaded at www.landauer.com. The report provides in-depth analysis of current industry conditions and the outlook for the future in five different property types. The publication provides one

analysis of the conditions in major markets for each property type. The report is published annually.

Evaluating Going Concern

The current business environment and market conditions might lead to rapidly deteriorating operating results and liquidity challenges for some real estate companies, particularly those with reduced access to capital. A company particularly sensitive to negative changes in economic conditions can rapidly develop a liquidity crisis and ultimately fail. Certain conditions, considered in the aggregate, may lead you to question the entity's ability to continue as a going concern. These include negative trends, such as recurring operating losses or working capital deficiencies, financial difficulties in the form of loan defaults or denial of credit from suppliers, dependence on the success of a particular product that is not selling well, legal proceedings, loss of a principal customer or supplier, destabilization of a trading partner or contract counterparty, and excessive reliance on external financing rather than funds generated from operations.

Key in evaluating these risk factors is whether:

- Existing conditions and events can be mitigated by management's plans and their effective implementation.
- The company has the ability to control the implementation of mitigating plans rather than being dependent on actions of others.
- The company's assumption about its ability to continue as a going concern is based on realistic, rather than overly optimistic, assessments of its access to needed debt or equity capital or its ability to sell assets in a timely manner.
- Liquidity challenges have been appropriately satisfied and disclosed.

When evaluating management's plans to continue as a going concern, an appropriate level of professional skepticism is important. For example, you may want to scrutinize the company's assumptions to continue as a going concern to assess whether those assumptions are based on overly optimistic or "once-in-a-lifetime" occurrences.

Key factors in your evaluation of the ability to continue as a going concern are part of the guidance provided in SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU sec. 341).

Auditing in a Paperless Environment

When clients rely on technology to manage and analyze information, audit strategies change. Consider the following examples:

- Audit evidence that previously existed in paper form may be available electronically only. Accessing electronic audit evidence may require you to become proficient in the use of data extraction or other audit software tools.
- The design and operation of internal control in a computer environment is much different than in a predominately manual environment.

As real estate entities continue to expand their use of IT, you may need to become aware of the unique audit issues in a highly computerized environment. In addition, you should identify the risks of material misstatement that can arise during the transition from a highly manual environment to a more computerized operating environment.

For further information and guidance on auditing in this paperless environment, see SAS No. 94, *The Effect of Information Technology on the Auditor's Evaluation of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 319).

Risks of Overseas Expansion

According to a recent survey by DTZ International Property Advisers of Switzerland (DTZ), 70 percent of real estate investors hold overseas real estate assets. The survey questioned representatives from investment vehicles, institutions, and property companies and found that the majority of respondents go overseas to achieve superior returns. Europe emerges as their most popular investment target. The survey also reveals that this trend is set to continue, with 43 percent of respondents planning to increase overseas real estate investment in the short term; 60 percent plan to increase their overseas exposure within the next three to five years; and 57 percent plan to increase overseas activities over the longer term.

When looking to buy overseas, the investors often cite economic performance, market size, and the tax and operating environment as key factors in identifying suitable markets. The lack of local market knowledge appears to be the major stumbling block. To overcome this challenge, the most popular method of entry into overseas markets is via joint ventures with local partners.

Competing in foreign markets is complex and fraught with risks, many of which are indiscernible at first glance. The political risks in some nations are quite high, but even in countries that have relative political stability, complexities may arise. Each country has its own market characteristics, regulations and laws, and accounting standards. If your client has or is considering venturing into foreign real estate markets, you should gain an understanding of the risks of doing business in those markets. Consider whether the client has an effective process for identifying and managing those risks. For example, has management adequately assessed the realities of a foreign marketplace when developing assumptions about the future performance of real estate located in those markets?

Changes in Internal Control

Large layoffs, staff reductions, and notifications to employees of impending termination can affect internal control over financial accounting and reporting systems. Remaining employees may feel overwhelmed by their workloads, lack of time to complete tasks and consider decisions, and simply be performing too many tasks and functions to meet the required levels of accuracy. In addition, rapid business expansion, changes in business strategies, and integration of different businesses may outstrip the ability of a company's financial systems to remain under effective internal control. Furthermore, controls at business units whose divestiture has been announced may be disrupted. As a result of any of these factors, internal control may become less effective or even ineffective.

Relevant considerations are whether:

- The attention to internal control has been maintained in the face of significant changes in the business.
- As a result of unfilled positions, key control procedures are no longer being performed, are being performed less frequently, or are being performed by individuals lacking proper understanding to identify and correct errors.
- Layoffs of IT personnel have had a negative effect on the entity's ability to initiate, process, or record its transactions, or maintain the integrity of information generated by the IT system.
- Key functions that should be segregated are now being performed by one person.
- The impact of changes to the control environment has altered internal control effectiveness and potentially resulted in a material control weakness.
- Changes in internal control caused by past or pending layoffs or staff reductions create an opportunity for fraudulent activities, including misappropriation of assets.

Transactions Involving Off-Balance-Sheet Arrangements, Including Special Purpose Entities

Some real estate entities make use of off-balance-sheet arrangements to conduct financing or other business activities. These may involve unconsolidated, nonindependent, limited purpose entities, often referred to as structured finance or special purpose entities (SPEs). These entities may be used to provide financing, liquidity, or market risk or credit support, or may involve leasing, hedging, or research and development services. See the AICPA general *Audit Risk Alert — 2002/03* for a detailed discussion about risks and audit procedures concerning this area.

Audit and Accounting Issues of Continuing Importance

Revenue Recognition

During the past few years of industry recovery, many real estate entities were able to report impressive growth as a result of the improvement in the underlying real estate. But after suffering through last year's recession, some entities may be under increased pressure to maintain the previous rate of growth.

You might want to consider the appropriateness of your client's revenue recognition policies or, especially, changes to those policies. Some clients attempt to demonstrate growth in a flattening market by changing operating or accounting policies that affect the timing or propriety of revenue recognition. In evaluating the revenue recognition policies of real estate entities, you should consider carefully whether the criteria in FASB Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*, have been met.

You should also continue to be alert for the following:

- *"Put" arrangements*. These arrangements may commit a seller, its officers, or shareholders to repurchase the property, find other buyers, or indemnify the buyer or third-party guarantors for risk of loss. These arrangements can significantly affect revenue recognition. In a number of cases, put arrangements may not be formally documented, so you should consider the facts and circumstances surrounding property sales to be sure there are no formal or informal arrangements of this kind. You may also wish to request written representation from management regarding the absence of such agreements.
- *Direct or indirect seller financing*. Consider circumstances that would indicate that a seller might have directly or indirectly provided the funds for a down payment (or for the entire purchase price) in a cash sale. Apart from precluding the use of the full accrual method of profit recognition, such circumstances may create related-party transactions

that require disclosure, as described in FASB Statement No. 57, *Related Party Disclosures.*

FASB Statement No. 66 describes examples of real estate transactions that include sales of corporate stock of enterprises with substantial real estate, partnership interests, and time-sharing interests. Questions have been raised about whether the sale of these investments should be accounted for under FASB Statement No. 66 or under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* In Emerging Issues Task Force (EITF) Issue 98-8, *Accounting for Transfers of Investments That Are in Substance Real Estate,* a consensus was reached that the sale or transfer of an investment in the form of a financial asset is, in substance, real estate and should be accounted for in accordance with FASB Statement No. 66.

FASB Interpretation No. 43, *Real Estate Sales,* clarifies that FASB Statement No. 66 applies to all real estate sales, not just those made by real estate entities. Included within the scope of FASB Statement No. 66 are sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs.

Lease Income

Several accounting pronouncements provide guidance to lessors on recognizing lease revenue. These pronouncements include the following:

- *FASB Statement No. 13,* Accounting for Leases. Paragraph 19(b) of this Statement describes how a lessor should report lease income, as follows:

  — In general, rental income is recognized when it becomes receivable according to the provisions of the lease.

  — However, if the rentals vary from a straight-line basis, the income should be recognized on a straight-line basis (unless another systematic and rational basis is more representative of the time pattern in which use benefit from the lease property is diminished).

- *FASB Statement No. 29,* Determining Contingent Rentals. This statement defines contingent rentals and states that they should be recognized as revenue when they become accruable.
- *FASB Technical Bulletin 85-3,* Accounting for Operating Leases with Scheduled Rent Increases. This Technical Bulletin addresses whether it is appropriate for lessors to recognize scheduled rent increases on a basis other than as required in FASB Statement No. 13.
- *SEC Staff Accounting Bulletin (SAB) No. 101,* Revenue Recognition in Financial Statements. SABs are not rules or interpretations of the SEC, but represent practices followed by SEC staff in administering the disclosure requirements of the federal securities laws. As clarified in Interpretive Response No. 8, a landlord should not recognize any contingent rental income until the threshold for contingent rental payments has passed.

In auditing rental income, you should obtain reasonable assurance that rental income has been properly recognized during the period. Pay particular attention to revenue from contingent rentals and revenue recognition when lease payments are scheduled to vary from a straight-line basis.

To properly recognize rental income on a straight-line basis, the accounting for income from lease arrangements that call for scheduled rent increases requires the recording of a receivable during the early years of the lease. If your client's financial statements include such a receivable, you should determine that it is collectible, for example, by assessing the creditworthiness of the tenant.

Help Desk—Auditors designing and performing procedures related to revenue recognition can look to the AICPA publication *Auditing Revenue in Certain Industries* (product no. 012510kk).

Sale-Leaseback Transactions

Industry observers continue to report a growing number of sale-leaseback transactions involving corporations that own their facilities. Real estate entities may participate in these transactions as the purchaser-lessor.

FASB Statement No. 13 describes the accounting by the purchaser-lessor in a sale-leaseback transaction, as follows:

- If the lease meets the criteria for classification as a capital lease, the purchaser-lessor should record the transaction as a purchase and a direct financing lease.
- If the lease does not meet the criteria for classification as a capital lease, the purchaser-lessor should record the transaction as a purchase and an operating lease.

You can find the primary guidance on accounting by the seller-lessee in a sale-leaseback transaction in FASB Statement No. 98, *Accounting for Leases.*

Asset Impairment

Specific markets or properties in the real estate industry may not weather last year's recession well. For that reason, you should continue to be alert for the possible impairment of real estate assets.

FASB recently issued a Statement that provides the primary guidance on accounting for the impairment of real estate assets.

In general, the accounting for the impairment of real estate depends on whether the property is to be held for investment or held for disposal. Projects under development are accounted for in the same manner as those held for investment. FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* does not provide exceptions for assets subject to nonrecourse debt.

Real Estate Properties Held for Investment

Real estate held for investment and projects under development should be reported at cost, less accumulated depreciation, and should be evaluated for impairment if facts and circumstances indicate that impairment may have occurred. Conditions or events such as the following may indicate a need for assessing the recoverability of investments in real estate:

- Cash flows from operating activities are insufficient to cover debt service.
- Current occupancy rates indicate that future cash flows to be received are lower than the amounts needed to recover the carrying amount of the investment fully.
- Major tenants have experienced or are experiencing financial difficulties.
- A significant portion of leases will expire in the near term.
- Lessors are being forced to make significant concessions to rent property.
- Properties held for sale remain unsold at subsequent balance-sheet dates.
- Other investors have decided to cease providing support or reduce their financial commitment to a project or venture.
- Rental demand for a rental project currently under construction is not meeting projections.
- Auditors' reports on financial statements of investee properties are modified for reasons that relate to real estate investments (for example, an auditor's report on the financial statements of investee properties that is modified for a departure from GAAP attributable to the improper valuation of assets).

If events and circumstances indicate that impairment may exist, the entity is required to estimate the future cash flows expected to result from the use of the asset and its eventual disposition. An asset is deemed to be impaired if its carrying amount exceeds the sum of the expected future cash flows (undiscounted and without interest charges) from the asset. The impairment is measured as the amount by which the carrying amount exceeds the fair value of the asset. After recognizing an impairment, the entity should account for the reduced carrying amount of the asset as the new cost of the asset and depreciate it over the remaining useful life. Restoration of previously recognized impairment losses is prohibited.

Lack of an asset-impairment evaluation system may indicate a material weakness in an entity's internal controls. Further, a lack of documentation generally increases the extent to which you must apply professional judgment in evaluating the adequacy of management's write-downs.

Real Estate to Be Disposed of by Sale

Real estate to be disposed of by sale (real estate for which management has committed to a plan of disposal by sale) should be reported at the lower of the carrying amount or fair value, less costs to sell. Subsequent revisions to fair value less costs to sell should be reported as adjustments to the carrying amount of the asset to be disposed of. Nevertheless, the carrying amount may not be adjusted to an amount greater than the carrying amount of the asset before an adjustment was made to reflect the decision to dispose of the asset. Determination of whether the carrying amounts of real estate projects require write-downs should be done on a project-by-project basis, in accordance with paragraph 24 of FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects.*

Some real estate might have previously been subject to APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions.* FASB Statement No. 144 amended APB Opinion No. 30. The provisions of FASB Statement No. 144 apply to all long-lived assets. Therefore, gains or losses on a disposal of a discontinued operation are no longer measured on a net realizable value basis, and future operating losses are no longer recognized before they occur.

Assets to Be Disposed of Other Than by Sale

Assets that are to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spinoff are to be considered as held and used until they are disposed of. If the asset is to be abandoned, the depreciable life is revised in accordance with APB Opinion No. 20, *Accounting Changes*. If the asset is to be exchanged for a similar productive asset or distributed to owners in a spinoff and if the carrying amount of the asset exceeds its fair value at the date of exchange or distribution, an impairment loss is to be recognized at that date.

Non-GAAP Measures of Performance

In 1999, the National Association of Real Estate Investment Trusts (NAREIT) issued recommendations with respect to clarifying the industry's supplemental performance benchmark, called Funds From Operations (FFO). These recommendations include the following:

- The industry's supplemental performance measure should include all operating results, both recurring and nonrecurring, except those results defined as "extraordinary items" under GAAP and gains and losses from sales of depreciable operating property.
- The industry's supplemental performance measure should continue to be labeled "Funds From Operations."
- The clarification of FFO is effective January 1, 2000.
- Calculation of FFO based on this clarification should be shown for all periods presented in financial statements or tables.
- Disclosures should include the information included in the NAREIT white paper on FFO and in NAREIT National Policy Bulletins related to reporting FFO.

These recommendations were based on a year-long evaluation of the industry's supplemental performance benchmark at the direction of NAREIT's leadership. NAREIT surveyed member company executives, investment analysts, institutional investors, and other industry participants regarding the effectiveness of FFO.

However, the SEC staff has noted that FFO has been discussed outside of the financial statements in several recent filings with the SEC. Neither GAAP nor SEC authoritative accounting literature provides a definition of FFO, and the SEC staff's views on the presentation of supplemental earnings measures and cash-flow measures as a proxy for net income and the presentation of funds generated from operations are expressed in Accounting Series Release (ASR) No. 142 (Section 202 of SEC's *Financial Reporting Policies*). ASR No. 142 states that if such measurements of economic performance are presented in the MD&A section or elsewhere, they should not be presented in such a manner that gives them greater authority or prominence than conventionally computed earnings. In no event should the presentation leave the reader with the impression that FFO is the primary measure of operating performance for the REIT or an appropriate measure for which dividends are computed and based. In addition, ASR No. 142 does not allow these supplemental earnings or cash-flow measures to be reported on a per-share basis. Net income and cash flows from operating, investing, and financing activities remain the appropriate measures.

Effect of FASB Statement No. 144 on FFO

After considering the impact of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, on income statements prepared using GAAP and on FFO, NAREIT's board of governors adopted several recommendations of the Association's Best Financial Practices Council. Chief among them is affirmation of NAREIT's commitment to GAAP net income as the primary industry earnings measure.

The board of governors also adopted a recommendation that FFO from income-producing property held for sale, sold, or otherwise transferred and now reported in "results of discontinued operations" should be included in consolidated FFO.

The resulting clarification of NAREIT's white paper on FFO was needed to ensure that a change in GAAP classification made by FASB Statement No. 144 did not create an inappropriate and unintended change in reported FFO. The clarification results in no change to FFO—mirroring the impact of FASB Statement No. 144 on GAAP net income.

New Auditing and Attestation Pronouncements and Other Guidance

Presented below is a list of auditing and attestation pronouncements, guides, and other guidance issued since the publication of last year's Alert. For information on auditing and attestation standards issued subsequent to the writing of this Alert, please refer to the AICPA Web site at www.aicpa.org/members/div/auditstd/technic.htm. You may also look for announcements of newly issued standards in the *CPA Letter*, *Journal of Accountancy*, and the quarterly electronic newsletter, *In Our Opinion*, issued by the AICPA Auditing Standards team and available at www.aicpa.org.

SAS No. 95	*Generally Accepted Auditing Standards*
SAS No. 96	*Audit Documentation*
SAS No. 97	*Amendment to Statement on Auditing Standards No. 50,* Reports on the Application of Accounting Principles
SAS No. 98	*Omnibus Statement on Auditing Standards—2002*
SAS No. 99	*Consideration of Fraud in a Financial Statement Audit*
SAS No. 100	*Interim Financial Information*
SOP 02-1	*Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code*
SSAE No. 11	*Attest Documentation*
SSAE No. 12	*Amendment to Statement on Standards for Attestation Engagements No. 10,* Attestation Standards: Revision and Recodification
SQCS No. 6	*Amendment to Statement on Quality Control Standards No. 2,* System of Quality Control for a CPA Firm's Accounting and Auditing Practice
Audit Guide	*Service Organizations: Applying SAS No. 70, as Amended*
Audit and Accounting Guide	*Audits of State and Local Governments* (GASB 34 Edition)
Auditing Interpretation No. 4 of SAS No. 70	"Responsibilities of Service Organizations and Service Auditors With Respect to Forward-Looking Information in a Service Organization's Description of Controls"

Auditing Interpretation No. 5 of SAS No. 70	"Statements About the Risk of Projecting Evaluations of the Effectiveness of Controls to Future Periods"
Auditing Interpretation No. 14 of SAS No. 58	"Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and in Accordance With International Standards on Auditing"
Auditing Interpretation No. 12 of SAS No. 1	"The Effect on the Auditor's Report of an Entity's Adoption of a New Accounting Standard That Does Not Require the Entity to Disclose the Effect of the Changes in the Year of Adoption"
Auditing Interpretation No. 15 of SAS No. 58	"Reporting as Successor Auditor When Prior-Period Audited Financial Statements Were Audited by a Predecessor Auditor Who Has Ceased Operations"
Related-Party Toolkit	*Accounting and Auditing for Related Parties and Related Party Transactions: A Toolkit for Accountants and Auditors*
Practice Alert No. 02-1	*Communications With the Securities and Exchange Commission*
Practice Alert No. 02-2	*Use of Specialists*
Practice Alert No. 02-3	*Reauditing Financial Statements*
Practice Aid	*Fraud Detection in a GAAS Audit*
Practice Aid	*New Standards, New Services: Implementing the Attestation Standards*
Practice Aid	*Assessing the Effect on a Firm's System of Quality Control Due to a Significant Increase in New Clients and/or Experienced Personnel*
Booklet	*Understanding Audits and the Auditor's Report: A Guide for Financial Statement Users*

The following summaries are for informational purposes only and should not be relied upon as a substitute for a complete reading of the applicable standard. To obtain copies of AICPA standards and guides, contact the Member Satisfaction Center at (888) 777-7077 or go online at www.cpa2biz.com.

SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*

SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*, supersedes Statement on Auditing Standards No. 82, *Consideration of Fraud in a Financial Statement Audit* (AU sec. 316); amends SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 230, "Due Professional Care in the Performance of Work"); and amends

SAS No. 85, *Management Representations* (AICPA, *Professional Standards*, vol. 1, AU sec. 333), as amended. The Statement does not change the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud as stated in SAS No. 1 (AU sec. 110.02).[2] However, SAS No. 99 establishes standards and provides guidance to auditors in fulfilling that responsibility, as it relates to fraud, in an audit of financial statements conducted in accordance with generally accepted auditing standards (GAAS).[3]

The following is an overview of the content of the SAS No. 99, with references to paragraphs in the new fraud standard:

- *Description and characteristics of fraud.* This section describes fraud and its characteristics. (See paragraphs 5 through 12.)
- *The importance of exercising professional skepticism.* This section discusses the need for auditors to exercise professional skepticism when considering the possibility that a material misstatement due to fraud could be present. (See paragraph 13.)
- *Discussion among engagement personnel regarding the risks of material misstatement due to fraud.* This section requires, as

2 The auditor's consideration of illegal acts and responsibility for detecting misstatements resulting from illegal acts is defined in SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317). For those illegal acts that are defined in that Statement as having a direct and material effect on the determination of financial statement amounts, the auditor's responsibility to detect misstatements resulting from such illegal acts is the same as that for errors (see SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* [AICPA, *Professional Standards*, vol. 1, AU sec. 312]), or fraud.

3 Auditors are sometimes requested to perform other services related to fraud detection and prevention, for example, special investigations to determine the extent of a suspected or detected fraud. These other services usually include procedures that extend beyond or are different from the procedures ordinarily performed in an audit of financial statement in accordance with generally accepted auditing standards. Chapter 1, "Attest Engagements," of Statements on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1, AT sec. 101), and Statements on Standards for Consulting Services (AICPA, *Professional Standards*, vol. 2, CS sec. 100) provide guidance to accountants relating to the performance of such services.

part of planning the audit, that there be a discussion among the audit team members to consider how and where the entity's financial statements might be susceptible to material misstatement due to fraud and to reinforce the importance of adopting an appropriate mindset of professional skepticism. (See paragraphs 14 through 18.)

- *Obtaining the information needed to identify risks of material misstatement due to fraud.* This section requires the auditor to gather information necessary to identify risks of material misstatement due to fraud, by:
    1. Inquiring of management and others within the entity about the risks of fraud. (See paragraphs 20 through 27.)
    2. Considering the results of the analytical procedures performed in planning the audit. (See paragraphs 28 through 30.)
    3. Considering fraud risk factors. (See paragraphs 31 through 33, and the appendix, "Examples of Fraud Risk Factors.")
    4. Considering certain other information. (See paragraph 34.)
- *Identifying risks that may result in a material misstatement due to fraud.* This section requires the auditor to use the information gathered to identify risks that may result in a material misstatement due to fraud. (See paragraphs 35 through 42.)
- *Assessing the identified risks after taking into account an evaluation of the entity's programs and controls.* This section requires the auditor to evaluate the entity's programs and controls that address the identified risks of material misstatement due to fraud, and to assess the risks taking into account this evaluation. (See paragraphs 43 through 45.)
- *Responding to the results of the assessment.* This section emphasizes that the auditor's response to the risks of material misstatement due to fraud involves the application of professional skepticism when gathering and evaluating audit

evidence (see paragraph 46). The section requires the auditor to respond to the results of the risk assessment in three ways:

1. A response that has an overall effect on how the audit is conducted, that is, a response involving more general considerations apart from the specific procedures otherwise planned (See paragraph 50.)
2. A response to identified risks that involves the nature, timing, and extent of the auditing procedures to be performed (See paragraphs 51 through 56.)
3. A response involving the performance of certain procedures to further address the risk of material misstatement due to fraud involving management override of controls (See paragraphs 57 through 67.)

- *Evaluating audit evidence.* This section requires the auditor to assess the risks of material misstatement due to fraud throughout the audit and to evaluate at the completion of the audit whether the accumulated results of auditing procedures and other observations affect the assessment. (See paragraphs 68 through 74.) It also requires the auditor to consider whether identified misstatements may be indicative of fraud and, if so, directs the auditor to evaluate their implications. (See paragraphs 75 through 78.)
- *Communicating about fraud to management, the audit committee, and others.* This section provides guidance regarding the auditor's communications about fraud to management, the audit committee, and others. (See paragraphs 79 through 82.)
- *Documenting the auditor's consideration of fraud.* This section describes related documentation requirements. (See paragraph 83.)

SAS No. 99 also includes an exhibit, "Management Antifraud Programs and Controls: Guidance to Help Deter, Detect, and Prevent Fraud," which has been developed to assist auditors in obtaining an understanding of programs and controls established by management to mitigate specific risks of fraud, or that otherwise help to prevent, deter, and detect fraud. SAS No. 99 is effective for audits of financial statements for periods beginning on or after December 15, 2002. Early application of the provisions of SAS No. 99 is permissible.

The AICPA has developed a Practice Aid titled *Fraud Detection in a GAAS Audit: SAS No. 99 Implementation Guide,* which will be published by the end of 2002. The Practice Aid includes topics such as how the new SAS changes audit practice, characteristics of fraud, understanding the new SAS, best practices, and practice aids such as, specialized industry fraud risk factors, common frauds, and extended audit procedures. Auditors should be on the lookout for this new publication (see the section titled "Practice Aid *Fraud Detection in a GAAS Audit*" later in this Alert for more information).

Practice Alert 02-2, *Use of Specialists*

The AICPA Securities and Exchange Commission Practice Section (SECPS) Executive Committee established a Professional Issues Task Force (PITF), which formulates guidance based on issues arising in peer reviews, firm inspections, and litigation to facilitate the resolution of emerging audit practice issues. This guidance takes the form of Practice Alerts. The information contained in these Practice Alerts is nonauthoritative. It represents the views of the members of the PITF and does not represent official positions of the AICPA.

Auditors may encounter difficulty in determining the appropriate situations in which to use a specialist and, in those cases when a specialist is appropriately used, understanding the findings of the specialist. The current guidance when specialists are used is broad and focuses on the use of all kinds of specialists. The purpose of Practice Alert 02-2 is to assist auditors in understanding their responsibilities with respect to both the use of specialists that have been engaged or employed by the audit client and the use of specialists engaged or employed by the audit firm.

Practice Aid *Fraud Detection in a GAAS Audit*

In connection with the issuance of SAS No. 99, the AICPA has developed a Practice Aid to help practitioners implement the new fraud guidance. The practice aid is entitled *Fraud Detection in a GAAS Audit: SAS No. 99 Implementation Guide* (product no. 006613) and will be available in December 2002. The Practice Aid includes topics such as:

- How the new SAS changes audit practice
- Characteristics of fraud
- Understanding the new fraud SAS
- Best practices
- Practice aids, such as:
  - —Specialized industry fraud risk factors
  - —Common frauds and extended audit procedures

The Practice Aid represents valuable guidance in helping practitioners understand and implement SAS No. 99.

New Accounting Pronouncements and Other Guidance

Presented below is a list of accounting pronouncements and other guidance issued since the publication of last year's Alert. For information on accounting standards issued subsequent to the writing of this Alert, please refer to the AICPA Web site at www.aicpa.org, and the FASB Web site at www.fasb.org. You may also look for announcements of newly issued standards in the *CPA Letter* and *Journal of Accountancy.*

FASB Statement No. 145	*Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.*
FASB Statement No. 146	*Accounting for Costs Associated with Exit or Disposal Activities*

FASB Statement No. 147	*Acquisitions of Certain Financial Institutions, an amendment of FASB Statements No. 71 and 144 and FASB Interpretation No. 9*
SOP 01-5	*Amendments to Specific AICPA Pronouncements for Changes Related to the NAIC Codification*
SOP 01-6	*Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*
Technical Practice Aid	*Software Revenue Recognition*
Questions & Answers	*FASB Statement No. 87, Employers' Accounting for Pensions*

The following summaries are for informational purposes only and should not be relied upon as a substitute for a complete reading of the applicable standard. For information on accounting standards issued subsequent to the writing of this Alert, please refer to the AICPA Web site at www.aicpa.org, and the FASB Web site at www.fasb.org.

FASB Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*

In April 2002, the FASB issued Statement No. 145, which rescinds FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, and an amendment of that Statement, FASB Statement No. 64, *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements*, thereby eliminating the requirement that gains and losses from debt extinguishments be classified as extraordinary items. Instead, those entities should use the provisions of APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, as amended and interpreted, to report debt extinguishments in fiscal years beginning after May 15, 2002, with earlier application encouraged. Other effective dates apply to the other provisions of FASB Statement No. 145. This Statement also rescinds FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers*. This Statement amends FASB Statement No. 13, *Accounting for Leases*, as well, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changing conditions.

The provisions of this Statement related to the rescission of FASB Statement No. 4 should be applied in fiscal years beginning after May 15, 2002. Any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented that does not meet the criteria in Opinion No. 30 for classification as an extraordinary item should be reclassified. Early application of the provisions of this Statement related to the rescission of FASB Statement No. 4 is encouraged.

The provisions in paragraphs 8 and 9(c) of this Statement related to FASB Statement No. 13 should be for transactions occurring after May 15, 2002, with early application encouraged. All other provisions of this Statement shall be effective for financial statements issued on or after May 15, 2002, with early application encouraged.

Early application of the provisions of this Statement may be as of the beginning of the fiscal year or as of the beginning of the interim period in which this Statement is issued.

On the Horizon

Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. Presented below is brief information about some ongoing projects that may be relevant to your engagements. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing GAAP or GAAS.

The following table lists the various standard-setting bodies' Web sites where information may be obtained on outstanding exposure drafts, including downloading a copy of the exposure draft.

These Web sites contain much more in-depth information about proposed standards and other projects in the pipeline.

Standard-Setting Body	*Web Site*
AICPA Auditing Standards Board (ASB)	www.aicpa.org/members/div/auditstd/drafts.htm
AICPA Accounting Standards Executive Committee (AcSEC)	www.aicpa.org/members/div/acctstd/edo/index.htm
Financial Accounting Standards Board (FASB)	www.rutgers.edu/Accounting/raw/fasb/draft/draftpg.html
Professional Ethics Executive Committee (PEEC)	www.aicpa.org/members/div/ethics/index.htm

Help Desk—The AICPA's standard-setting committees are now publishing exposure drafts of proposed professional standards exclusively on the AICPA Web site. The AICPA will notify interested parties by e-mail about new exposure drafts. To be added to the notification list for all AICPA exposure drafts, send your e-mail address to memsat@aicpa.org. Indicate "exposure draft email list" in the subject header field to help process your submission more efficiently. Include your full name, mailing address and, if known, your membership and subscriber number in the message.

Auditing Pipeline

Exposure Draft on Auditing Fair Value Measurements and Disclosures

The AICPA's Auditing Standards Board (ASB) has issued an exposure draft of a proposed SAS titled *Auditing Fair Value Measurements and Disclosures.* The proposed SAS addresses auditing considerations relating to measurement, presentation, and disclosure of assets, liabilities, and specific components of equity presented or disclosed at fair value in financial statements. A vote to ballot a document for final issuance is expected to occur in December 2002.

New Framework for the Audit Process

The ASB is reviewing the auditor's consideration of the risk assessment process in the auditing standards, including the necessary understanding of the client's business and the relationships among inherent, control, fraud, and other risks. The ASB expects to issue a series of exposure drafts in before the end of 2002. Some participants in the process expect the final standards to have an effect on the conduct of audits that has not been seen since the "Expectation Gap" standards were issued in 1988.

Some of the more important changes to the standards that are expected to be proposed are:

- A requirement for a more robust understanding of the entity's business and environment that is more clearly linked to assessment of the risk of material misstatement of the financial statements. Among other things, this will improve the auditor's assessment of inherent and control risks and eliminate the "default" to assess either of these risks at the maximum.
- An increased emphasis on the importance of entity controls with clearer guidance on what constitutes a sufficient knowledge of controls to plan the audit.
- A clarification of how the auditor may obtain evidence about the effectiveness of controls in obtaining an understanding of controls.
- A clarification of how the auditor plans and performs auditing procedures differently for higher and lower assessed risks of material misstatement at the assertion level while retaining a "safety net" of procedures.

These changes collectively are intended to improve the guidance on how the auditor uses the audit risk model.

In connection with this major initiative, the ASB and the International Auditing and Assurance Standards Board (IAASB) have agreed to form a joint task force to develop joint standards addressing the risk assessment process. These standards will represent a significant step toward converging U.S. and international auditing standards. These proposed standards are being exposed now.

You should keep abreast of the status of these projects and projected exposure drafts, inasmuch as they will substantially affect the audit process. More information can be obtained on the AICPA's Web site at www.aicpa.org.

Accounting Pipeline

Consolidation of Certain Special-Purpose Entities

The FASB has issued an exposure draft of a proposed Interpretation, *Consolidation of Certain Special-Purpose Entities*, of ARB No. 51, *Consolidated Financial Statements*. This proposed Interpretation would address consolidation by business enterprises of SPEs to which the usual condition of consolidation described in Accounting Research Bulletin No. 51 does not apply because the SPEs have no voting interest or otherwise are not subject to control through ownership of voting interests. A final Statement is expected to be issued during the fourth quarter of 2002.

Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Proposed AICPA SOP, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment,* and proposed FASB Statement of Financial Accounting Standards, *Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant, and Equipment—an amendment of APB Opinions No. 20 and 28 and FASB Statements No. 51 and 67 and a rescission of FASB Statement No. 73,* are being issued simultaneously for public comment.

Principally, the proposed FASB Statement would amend FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, to exclude from its scope the accounting for acquisition, development, and construction costs of real estate developed and used by an entity for subsequent rental activities. The accounting for those costs would be subject to the guidance in the proposed SOP. It also would amend APB Opinion No. 28, *Interim Financial Reporting*, to require that those costs that the proposed SOP would require be expensed as incurred on an annual basis also be expensed as incurred in interim periods.

The proposed SOP addresses accounting and disclosure issues related to determining which costs related to property, plant, and equipment should be capitalized as improvements and which should be charged to expense. The proposed SOP also addresses capitalization of indirect and overhead costs and component accounting for property, plant, and equipment. Final Statements are expected to be issued during the first half of 2003.

Proposed AICPA SOP Related to Real Estate Time-Sharing Transactions

This proposed SOP will address several key issues affecting the sellers of real estate time-sharing arrangements. These issues include revenue recognition, determining the allowance for uncollectible receivables, and the deferring of selling costs. At its September 2001 meeting, the Accounting Standards Executive Committee (AcSEC) approved for exposure, subject to AcSEC's positive clearance of certain revisions and FASB clearance, a draft SOP titled *Accounting for Real Estate Time-Sharing Transactions*. AcSEC expects to issue the exposure draft in the first quarter of 2003.

Tentative conclusions to date include the following:

- *Basic accounting model.* The underlying structural basis for the time-sharing model is the retail land sales model of FASB Statement No. 66, with inclusion of certain of the fundamental principles of the other-than-retail-land-sales model of that Statement.
- *Basic accounting model—Buyer's commitment test.* The accounting model's test for buyer's commitment is a 10 percent-of-principle test, similar to that of the FASB Statement No. 66 retail land sales model, which would be met by receipt by the seller of cumulative down payments of at least 10 percent of the sales price.

- *Basic accounting model—Collectibility-of-receivables test.* Collectibility is demonstrated either by meeting a test based on collection of 85 percent of prior similar projects' receivables dollars or by the seller's collection of cumulative principle payments of at least 25 percent of the sales price.
- *Basic accounting model—Estimability-of-credit-losses test.* The estimability-of-credit-losses test is a nonbright-line test, subject to certain criteria, whereby a time-sharing entity would have to have sufficient collection experience to demonstrate that it can reliably measure credit losses (analogous to the ability to estimate future returns discussed in FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*).
- *Meaning of credit losses.* For purposes of estimating credit losses in the collectibility-of-receivables and estimability-of-credit-losses tests, sales canceled subsequent to being recorded as sales should be considered credit losses, rather than sales reversals. A seller should interpret credit losses broadly to include all situations in which, as a result of credit concerns, less than 100 percent of a receivable is collected from a buyer. Costs related to credit losses (for example, collection costs) should not be incorporated into the seller's estimate of credit losses but should instead be charged to selling, general, and administrative expense as incurred.
- *Accounting for estimated and actual credit losses.* For sales (meeting the recognition criteria) that, based on historical and statistical information, are not expected to be collected, revenue should be reduced rather than bad debt expense charged.
- *Accounting for cost of sales and inventory.* The relative sales value method should be used to allocate inventory cost and determine the cost of sales when inventory relief is recorded as part of a sale.

- *Passage-of-title requirement.* Passage of nonreversionary title is a criterion for treating a time-sharing transaction as a sale rather than a lease.

- *Rentals of unsold interests.* Rentals are considered to be holding-period activities and are accounted for as "incidental operations." Incidental operations would be defined as in FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, except that the SOP's definition would not require that the purposes of those operations is to reduce the cost of developing the property for its intended use. Time-sharing interests should be accounted for as inventory rather than fixed assets, and therefore not be depreciated during times of rental.

- *Expensing versus deferral of selling costs.* Selling costs should be accounted for using the "directly associated" approach of paragraph 18 of FASB Statement No. 67, modified to include some restrictions similar to those in FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.*

- *Special purpose entities.* The issue involves SPE structures in which a seller transfers deeded title to a trust or third party (the SPE) in exchange for stock or other interests in the SPE, which the seller then sells to the time-share buyers. Sales should be recorded only upon the sale of the stock or interests to the time-share buyer, not upon transfer of title to the SPE. Generally, an SPE should be viewed as an entity lacking economic substance and established to facilitate sales. The seller should present in its balance sheet the unsold interests in the SPE as time-share inventory rather than apply consolidation or some other accounting method to the seller's interests in the SPE as the seller's ownership percentage in the SPE decreases during the sell-out of a project.

- *Amendments to Level A GAAP.* If the final SOP is issued, the FASB would remove from FASB Statement No. 66 the guidance related to time-sharing; that Statement would direct the reader to the SOP for guidance. The FASB would also modify FASB Statement No. 67 to exclude time-sharing transactions from the section in the Statement titled "Costs Incurred to Sell Real Estate Projects," in view of the SOP's prescribed "incremental" accounting for time-sharing selling costs.

Resource Central

Educational courses, Web sites, publications, and other resources available to CPAs

On the Bookshelf

The following publications deliver valuable guidance and practical assistance as potent tools to be used on your engagements.

- Audit and Accounting Guide *Common Interest Realty Associations 2002* (product no. 012572kk)
- Audit and Accounting Guide *Construction Contractors 2002* (product no. 012582kk)
- Audit Guide *Use of Real Estate Appraisal Information* (product no. 013159kk)
- Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (product no. 012520kk)
- Audit Guide *Auditing Revenue in Certain Industries* (product no. 012510kk)
- Audit Guide *Audit Sampling* (product no. 012530kk)
- Audit Guide *Analytical Procedures* (product no. 012551kk)
- Audit Guide *Service Organizations: Applying SAS No. 70, as Amended* (product no. 012772kk)
- Practice Aid *Auditing Estimates and Other Soft Accounting Information* (product no. 010010kk)

- *Accounting Trends & Techniques—2002*
- Practice Aid *Preparing and Reporting on Cash- and Tax-Basis Financial Statements* (product no. 006701kk)
- Practice Aid *Fraud Detection in a GAAS Audit—SAS No. 99 Implementation Guide* (publication by the end of 2002)
- General *Audit Risk Alert—2002/03* (product no. 022333kk)
- *Audit Risk Alert Compilation and Review 2002/03* (product no. 022303kk)
- *Audit Risk Alert Construction Contractors 2002/03* (product no. 022313kk)
- *Audit Risk Alert Common Interest Realty Associations 2002/03* (product no. 022275kk)
- *Audit Risk Alert E-Business Industry Developments—2002/03* (product no. 022323kk)

Audit and Accounting Manual

The *Audit and Accounting Manual* (product no. 005132kk) is a valuable nonauthoritative practice tool designed to provide assistance for audit, review, and compilation engagements. It contains numerous practice aids, samples, and illustrations, including audit programs; auditor's reports, checklists, and engagement letters; management representation letters; and confirmation letters.

AICPA reSOURCE Online: Accounting and Auditing Literature

Get access—anytime, anywhere—to the AICPA's latest *Professional Standards, Technical Practice Aids,* all Audit and Accounting Guides, all Audit Risk Alerts, and *Accounting Trends & Techniques.* To subscribe to this essential online service, go to cpa2biz.com.

Educational Courses

The AICPA has developed a number of continuing professional education (CPE) courses that are valuable to CPAs working in public practice and industry. Those courses include:

- *AICPA's Annual Accounting and Auditing Workshop* (product no. 737082kk (VHS tape/manual) and 187082kk (video)). Whether you are in industry or public practice, this course keeps you current and informed, and shows you how to apply the most recent standards.
- *Fair Value Accounting for Hedge Transactions* (product no. 735182kk). This course helps you understand GAAP for derivatives and hedging activities. Also, you will learn how to identify effective and ineffective hedges.
- *Fraud and the Financial Statement Audit: Auditor Responsibilities Under New SAS* (product no. 731810kk (text) and 181810kk (video); available December 31, 2002). The new fraud standard may not change your responsibilities for detecting fraud in a financial statement audit, but it will change how you meet that responsibility. Practitioners will benefit from a risk assessment approach to detecting fraud in a financial statement audit. You will learn the conceptual framework necessary to understand the characteristics of fraud.
- *Auditing for Internal Fraud* (product no. 730237kk). This course provides an auditor with the tools to identify fraud schemes. It trains CPAs to focus their analytical and substantive tests on the fraud triangle when evaluating internal controls. It also illustrates the latest in fraud prevention and detection programs implemented by industry leaders.
- *Identifying Fraudulent Financial Transactions* (product no. 730243kk). Learn to identify the red flags of fraud in financial information and to analyze a variety of fraud schemes. You will develop a framework for detecting financial statement fraud and learn about fraud schemes in revenue, inventory, liabilities, and assets.
- *Independence* (product no. 739058kk). This interactive CD-ROM course reviews the AICPA authoritative literature covering independence standards (including the newly issued SECPS independence requirements), SEC

regulations on independence, and Independence Standards Board (ISB) standards.

- *SEC Reporting* (product no. 736747kk). This course helps the practicing CPA and corporate financial officer learn to apply SEC reporting requirements. It clarifies the more important and difficult disclosure requirements.

- *E-Commerce: Controls and Audit* (product no. 731551kk). This course is a comprehensive overview of the world of e-commerce. Topics covered include internal control evaluation and audit procedures necessary for evaluating business-to-consumer and business-to-business transactions.

In addition to the general courses mentioned here, the following courses might be relevant to practitioners with real estate clients:

- Self-study—*Real Estate Accounting and Auditing*, by Michael Ramos (product no. 730599kk)

- Group study—*Real Estate Accounting and Auditing* (product no. 730600kk). This course is also available for in-firm delivery.

Online CPE

The AICPA offers an online learning tool, *AICPA InfoBytes*. An annual fee ($95 for members and $295 for nonmembers) provides unlimited access to over 1,000 hours of online CPE in one- and two-hour segments. Register today at infobytes.aicpaservices.org.

CPE CD-ROM

The Practitioner's Update (product no. 738450kk) CD-ROM helps you keep on top of the latest standards. Issued twice a year, this cutting-edge course focuses primarily on new pronouncements that will become effective during the upcoming audit cycle.

Real Estate Annual Conference

The AICPA sponsors an annual Real Estate Conference in the fall. For further information about the conference, contact the Member Satisfaction Team at (888) 777-7077 or visit the CPA2Biz Web site (cpa2biz.com) to view the latest conferences calendar and to register.

Member Satisfaction Center

To order AICPA products, receive information about AICPA activities, and find help on your membership questions, call the AICPA Member Satisfaction Center at (888) 777-7077.

Hotlines

Accounting and Auditing Technical Hotline

The AICPA Technical Hotline answers members' inquiries about accounting, auditing, attestation, compilation, and review services. Call (888) 777-7077.

Ethics Hotline

Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. Call (888) 777-7077.

Web Sites

AICPA Online and CPA2Biz

AICPA Online, at www.aicpa.org, offers CPAs the unique opportunity to stay abreast of matters relevant to the CPA profession. AICPA Online informs you of developments in the accounting and auditing world as well as developments in congressional and political affairs affecting CPAs. In addition, www.cpa2biz.com offers all the latest AICPA products, including the Audit Risk Alerts, Audit and Accounting Guides, the professional standards, and CPE courses.

Other Helpful Web Sites

Further information on matters addressed in this Audit Risk Alert is available through various publications and services offered by a number of organizations. Some of those organizations are listed in the table at the end of this Alert.

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This Audit Risk Alert replaces *Real Estate Industry Developments—2001/02. Real Estate Industry Developments* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's Alert, please feel free to share those with us. Any other comments that you have about the Alert would also be appreciated. You may e-mail these comments to ymishkevich@aicpa.org or write to:

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APPENDIX

THE INTERNET—AN AUDITOR'S RESEARCH TOOL

Here are some general Web sites that you may find useful to your practice.

Name of Site	*Content*	*Internet Address*
American Institute of CPAs	Summaries of recent auditing and other professional standards as well as other AICPA activities	www.aicpa.org
Financial Accounting Standards Board	Summaries of recent accounting pronouncements and other FASB activities	www.fasb.org
Governmental Accounting Standards Board	Summaries of recent accounting pronouncements and other GASB activities	www.gasb.org
Securities and Exchange Commission	The SEC Digest and Statements, EDGAR database, current SEC rulemaking	www.sec.gov
FASAB	Federal Accounting Standards Board	www.financenet.gov/fasab.htm
U.S. Federal Government Agencies Directory	A list of all federal agencies on the Internet	www.lib.lsu.edu/gov/fedgov.html
The Electronic Accountant	World Wide Web magazine that features up-to-the-minute news for accountants	www.electronicaccountant.com
CPAnet	Online community and resource center	www.cpalinks.com/
Guide to WWW for Research and Auditing	Basic instructions on how to use the Web as an auditing research tool	www.tetranet.net/users/gaostl/guide.htm
Accountant's Home Page	Resources for accountants and financial and business professionals	www.computercpa.com/

Name of Site	*Content*	*Internet Address*
U.S. Tax Code Online	A complete text of the U.S. Tax Code	www.fourmilab.ch/ustax/ustax.html
Federal Reserve Bank of New York	Key interest rates	www.ny.frb.org/pihome/statistics/dlyrates
FirstGov	Portal through which all government agencies can be accessed	www.firstgov.gov
Economy.com	Source for analysis, data, forecasts, and information on the United States and world economies	www.economy.com
International Federation of Accountants	Information on standards-setting activities in the international arena	www.ifac.org
Hoovers Online	Online information on various companies and industries	www.hoovers.com
Ask Jeeves	Search engine that uses a user-friendly question format and provides simultaneous search results from other search engines as well (for example, Excite, Yahoo, and AltaVista)	www.askjeeves.com

In addition to the general information provided above, the Internet covers a vast amount of information that may be valuable to auditors of real estate entities, including the following:

- Market forecasts and analyses by city and property type
- Discussions of current industry trends
- Benchmarking studies and comparative financial and nonfinancial data, for example, capitalization rates, occupancy statistics, and planned future development
- Articles and press releases relating to current industry items of interest
- Links to other real estate Internet sites

Some of the more relevant sites for those of you with real estate clients could include those shown in the following table:

Organization	*Internet Address*
Building Owners and Managers Association	www.boma.org
Commercial Investment Real Estate Network	www.ccim.com
Institute of Real Estate Management	www.irem.org
National Association of Real Estate Investment Trusts	www.nareit.org
National Council of Real Estate Investment Fiduciaries	www.ncreif.org
Real Estate Investment Advisory Council	www.reiac.org
American Resort Development Association	www.arda.org
Society of Industrial and Office Realtors	www.sior.com

The real estate practices of some of the larger CPA firms may also contain industry-specific auditing and accounting information that is helpful to practitioners.

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